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Department of the Treasury
Washington, DC 20224

Person To Contact: _____, ID No. _____
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Refer Reply To:
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PLR-129397-08
Date:
October 28, 2008

Trust:

Agreement:

Program:

Board:

Administrator:

City:

State:

Date:

Dear _____ :

This letter responds to a letter from your authorized representatives dated June 27, 2008, as well as additional correspondence, submitted on behalf of the City, requesting rulings that (1) the Trust's income is excludable from gross income under § 115 of the Internal Revenue Code and (2) the Trust is not required to file an annual federal income tax return. The City represents the facts as follows.

Issue 1 – § 115(1)

FACTS

The Board, consisting of designated City officers and employees, was established by the City to administer its pension and retirement system. With the assistance of the Administrator, it manages and invests City funds which provide medical, death, disability, and retirement benefits on behalf of active and former City officers and employees.

The Trust was established by the City on the Date, with the members of the Board serving as trustees. The Trust will allow for the prefunding of costs for health and welfare benefits under the Program. The Administrator will accept and account for contributions to the Trust and forward contributions to the custodian selected by the trustees for holding and administration. The trustees will invest and reinvest Trust assets and will pay benefits from the Trust solely to provide health and welfare benefits to eligible retirees and to the eligible spouses and dependents of retirees.

The retiree health benefits provided through the Program are self-insured. Both eligibility and cost of benefits vary based on hire date, years of service upon retirement, and whether the retiree or beneficiary is eligible for benefits under the Medicare program.

The City represents that the Program does not provide for any cash-out of unused amounts, is not funded by any conversion of sick or vacation days, and does not permit employee contributions for retiree medical benefits through pre-tax salary reduction elections.

The Agreement provides that in no event will Trust assets be distributed to, or revert to, any entity other than a state, a political subdivision of a state, or an entity whose income is excluded from gross income under § 115 of the Code. The Agreement states that there is no guaranty that payments or reimbursements to employees, former employees, or retirees will be tax-free, and that the requested ruling concerns only the federal tax treatment of the Trust's income and will have no effect on whether contributions to, or payments (including medical expense reimbursements) from, the City's health plans are excludable under the Code from the gross income of employees, former employees, or retirees.

LAW AND ANALYSIS

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Internal Revenue Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Trust provides health and welfare benefits to retired City employees and their spouses and dependents. Providing health and welfare benefits to former public employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, the Trust performs an essential governmental function within the meaning of § 115(1).

The income of the Trust accrues to the City. Any amounts remaining in the Trust after all health and welfare benefits, plus reasonable fees and expenses, have been paid are to be retained for payment of future health and welfare benefits until all City liabilities for such benefits have been satisfied. No private interests participate in, or

PLR-129397-08

benefit from, the operation of the Trust other than as providers of goods or services. The benefit to retired City employees is incidental to the public benefit. See Rev. Rul. 90-74.

Issue 2 – § 6012(a)(4)

FACTS

The Agreement provides that the trustees shall receive and accept all contributions and shall hold, invest, reinvest, manage, administer, and distribute property and the increments, proceeds, earnings, and income solely to provide health and welfare benefits to retirees and their eligible spouses and dependents.

The Agreement provides that no beneficiary shall have any right to take part in or direct the management or control of the business of the Trust or to act for or bind the Trust or the trustees or otherwise to transact any business on behalf of the Trust.

The Agreement provides, in general, that no portion of the principal or income of the Trust shall revert to the City, or shall be used for or diverted to any purpose other than to provide health and welfare benefits to retirees and their eligible spouses and dependents, and to pay the reasonable expenses of the Trust.

The Agreement provides that contributions to the Trust consist solely of (1) funds appropriated by the City pursuant to the City code, (2) amounts refunded from vendors and insurers to the City that are earmarked to the Trust; and (3) other amounts the City directs to the Trust. No employee contributions shall be allowed or accepted, except as might be permitted under the Code. The City represents that there are no current or past employee contributions to the Trust and that the Trust will not accept future employee contributions without a written determination by the Service that the Trust will continue to qualify as an “ordinary trust” within the meaning of § 7701(a) and § 301.7701-4(a) of the Procedure and Administration Regulations.

The Agreement provides that disbursements from the Trust are to be made for the sole purpose of assisting in the payment of health and welfare benefits for retirees and their eligible spouses and dependents (and for reasonable expenses and fees), and that any amounts remaining in the Trust after such disbursements are made are to be retained in the Trust for future payments, until all City liabilities for post-retirement health and welfare benefits have been satisfied.

LAW & ANALYSIS

Section 301.7701-1(b) of the regulations provides, in part, that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through -4, unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The City contributes money to the Trust to be used to pay health and welfare benefits for certain retirees of the City and their eligible spouses and dependents. The trustees are charged with protecting and conserving the Trust's assets for beneficiaries who cannot share in the discharge of this responsibility, and therefore, are not associates in a joint enterprise for the conduct of business for profit. Assuming that the Trust is recognized as a separate entity under § 301.7701-1, we conclude that the Trust is an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

RULINGS

Based solely on the facts and representations submitted by the Trust:

1. We conclude that the income of the Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Consequently, we rule that the Trust's income is excludable from gross income under § 115(1).
2. We conclude that the Trust is classified as a trust under § 301.7701-4(a). Section 6012(a)(4) does not require a trust without taxable income to make a return of income when gross income is less than \$600. Because the Trust's income is excludable from gross income under

PLR-129397-08

§ 115(1), we rule that the Trust is not required by § 6012(a)(4) to file an annual income tax return.

Except for the specific rulings above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding the federal tax consequences of contributions to, or payments from, the City's health plan(s), including (but not limited to) whether contributions to the plan(s) are excludable from the gross income of employees, former employees, or retirees under § 106 and whether payments from the plan(s) (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees, or retirees under §§ 104 or 105.

Section 3.01 of Rev. Proc. 2008-3, 2008-1 I.R.B. 110, provides that the Service will not issue a ruling on whether a self-insured medical reimbursement plan satisfies the requirements of § 105(h) for the plan year. Accordingly, we express or imply no opinion regarding whether the Program satisfies the nondiscrimination requirements of § 105(h) or § 1.105-1 of the Income Tax Regulations.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT
Assistant Chief
Exempt Organizations Branch 2
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosures: copy for § 6110 purposes